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November 15, 2005

AGENDA ITEM 6

TO: MEMBERS OF THE HEALTH BENEFITS COMMITTEE

I. SUBJECT: Medicare Part D Implementation

II. PROGRAM: Health Benefits

III. RECOMMENDATION: Staff recommends that the Board adopt Option C, Method 4:

1. distribute Medicare Part D Retiree Drug Subsidy (RDS) funds to the State of California in 2007 based on claims experience for prescription drug costs of State RDS-eligible members in 2006; and,
2. use the balance of RDS funds to reduce 2007 premiums for contracting agencies' Medicare Supplemental Plans.

IV. ANALYSIS:

Background

The Medicare Prescription Drug, Improvement and Modernization Act (MMA), signed into law in December 2003, established a voluntary outpatient prescription drug benefit program referred to as Medicare Part D (Part D) that will take effect January 1, 2006. Part D will generally provide a pharmacy benefit through approved Prescription Drug Plans (PDPs) and Medicare Advantage Prescription Drug Plans (MA-PDs) to Medicare eligibles who do not have pharmacy benefits through their employers.

As an incentive to employers who already provide high quality prescription drug coverage to their retirees, Part D includes an employer subsidy also known as the Retiree Drug Subsidy (RDS). The federal RDS payments are 28 percent of actual drug costs between $250 and $5,000 per calendar year for Medicare-eligible CalPERS retirees and their Medicare-eligible spouses and dependents ("RDS-eligible members").

CalPERS is a plan sponsor and may apply for and receive RDS funds. The MMA and federal regulations do not explicitly address the method of distribution of the RDS by plan sponsors.

MA-PDs, such as the Kaiser Senior Advantage Plan, are eligible to receive payments directly for Part D-eligible retirees who are enrolled in their plans. Such plans assume all risk and employers cannot claim the RDS funds for retirees enrolled in these plans.

In April 2005, the Board directed staff to:

1. Seek legislation to restrict enrollment in the CalPERS Health Benefits Program to Medicare-eligible members who do not enroll in an individual PDP. This bill (Negrete McLeod, AB 587) provides that CalPERS members enrolled in a PDP other than a Board-approved MA-PDs (such as Kaiser Senior Advantage) may not be enrolled in a CalPERS health benefit plan. Members who inadvertently sign up for Part D will have an opportunity to disenroll from Part D without losing CalPERS health benefits. (Though CalPERS cannot prohibit members from applying for Part D, existing CalPERS drug coverage is as good as or better than that provided under Part D. There is generally no benefit for CalPERS health plan members to apply for Part D.) AB 587 was signed by the Governor on October 5, 2005 (Stats. 2005, Ch 527, §1).
2. Apply for the RDS funds for Medicare-eligible members not enrolled in the Kaiser Senior Advantage plan offered by CalPERS. CalPERS submitted an application for the subsidy on behalf of all State and contracting agency employers, except the California Association of Highway Patrolmen, on an aggregated basis on October 26, 2005.
3. Re-evaluate CalPERS Part D options for 2007.

In September 2005, staff presented a recommendation for distribution of RDS funds. The HBC requested staff to re-examine the issue of distributing RDS funds, and to provide the pros and cons of all options.

Staff presented this analysis at the October 2005 Health Benefits Committee (HBC) meeting. Further action was deferred until November 2005, pending development of a more detailed pro-forma of administrative costs and a report on co-payment reduction alternatives and their cost impacts. These reports will be mailed under separate cover prior to the November 2005 HBC meeting.

Discussion

This agenda item provides the additional information requested by the HBC and continues to examine the options presented to the Health Benefits Committee in October 2005. These options can be placed into three broad categories:

A. Distribution of the RDS funds solely to employers.
B. Distribution of the RDS funds solely to RDS-eligible members.
C. Distribution of the RDS funds to both employers and RDS-eligible members.

Also included in this analysis is a description of a new method under the "Category C" option whereby distribution of RDS funds to State RDS-eligible members would be accomplished via prescription drug co-payment discount vouchers (see Method C-3).

All options described in this analysis would take effect for 2007. That is, all RDS funds accumulated in calendar year 2006 would be applied to calendar year 2007 benefits.

It should be noted that it is possible that the Legislature may withhold appropriations for state annuitants' health premiums in future Budget Acts in an amount equal to the RDS amounts generated by State RDS-eligible members, regardless of how CalPERS implements and distributes the RDS funds.

Staff recommends Option C, Method 4 (the same option recommended in October). CalPERS would distribute RDS funds to the State of California in 2007 based on claims experience for prescription drug costs of State RDS-eligible members in 2006, and use the balance of RDS funds to reduce 2007 premiums for contracting agencies' Medicare Supplemental plans. This is the best-balanced option that meets the evaluation criteria as discussed below.

In this analysis, as in prior agenda items, staff has assessed the degree to which the RDS options would:

- comply with the Public Employees' Medical and Hospital Care Act (PEMHCA) and the federal Health Information Portability and Accountability Act (HIPAA);
- maximize incentives for contracting agencies to remain in the CalPERS health benefits program in order to spread risk across the largest possible pool of members;
- not result in employers receiving RDS amounts that reflect more than their retiree health coverage premium contributions;
- allow a cost effective and administratively feasible method of implementation; and,
- benefit members.

<u>Option A: Distribution of the RDS funds solely to employers.</u>

The following describes four methods by which CalPERS could distribute the entire amount of the RDS to employers (State of California and contracting agencies).

Method A-1: Distribute the RDS funds to employers in 2007 based on claims experience for member prescription drug costs for RDS-eligible members in 2006.

Employers would receive 28 percent of drug costs between $250 and $5,000 per calendar year based on the claims experience for their RDS-eligible members.

PROS:

- Contracting agency employers will be less likely to leave the CalPERS Health Benefits Program if they receive the full amount of the RDS.
- Returns RDS funds most accurately to employers.

CONS:

- Not a viable option because of potential HIPAA violations. Under HIPAA, employee personal health information (PHI) must be protected from general exposure to employers. Staff has identified over 400 contracting agencies that have very low numbers of RDS-eligible members. In fact, over 100 contracting agencies have only one RDS-eligible member. Distribution of the RDS based on claims experience to these contracting agency employers would identify the individual(s) who had incurred the drug costs used to calculate the RDS. This would constitute a violation of HIPAA.
- Contracting agencies with low retiree health coverage contributions may receive RDS amounts that significantly exceed their retiree health coverage premium contributions.
- No direct benefit to members.

Method A-2: **Distribute RDS funds to employers in 2007 based on the proportion contributed toward retiree health premiums in 2006.**

For State and contracting agencies, CalPERS would calculate the amount to distribute to each employer by first calculating "contribution ratios" (the ratio of each employer's contribution toward retiree health coverage premiums to the total amount contributed toward retiree health coverage premiums by all eligible employers.) Secondly, this "contribution ratio" would be applied to the total RDS reimbursement CalPERS receives from the federal government in order to calculate each employer's share of the RDS.

PROS:

- Does not result in employers receiving RDS amounts that reflect more than their premium contributions.
- Avoids potential HIPAA violations.
- Contracting agency employers will be less likely to leave the CalPERS Health Benefits Program if they receive the full amount of the RDS.

CONS:

- Contracting agencies with low contributions toward premiums may not receive any RDS funds.
- No direct benefit to members.

Method A-3: **Distribute RDS funds to the State in 2007 based on claims experience for member prescription drug costs for 2006 (see Method A-1) and distribute RDS to contracting agencies in 2007 based on the proportion contributed toward retiree health premiums in 2006 (see Method A-2).**

PROS:

- Does not result in employers receiving RDS amounts that reflect more than their premium contributions.
- Avoids potential HIPAA violations.
- Contracting agency employers will be less likely to leave the CalPERS Health Benefits Program if they receive the full amount of the RDS.

CONS:

- Contracting agencies with low contributions toward premiums may not receive any RDS funds.
- No direct benefit to members.

Method A-4: Distribute RDS funds to employers in 2007 on a per capita basis.
Employers would receive a set amount for each of their RDS-eligible members, based on average prescription drug costs for these members. The average prescription drug cost would be calculated by dividing the total amount of drug expenditures by the total number of RDS-eligible members in the CalPERS program.

PROS:

- Avoids potential HIPAA violations.
- Contracting agency employers will be less likely to leave the CalPERS Health Benefits Program if they receive the full amount of the RDS.

CONS:

- Contracting agencies with low contribution toward premiums may receive RDS amounts that significantly exceed their premium contributions.
- No direct benefit to members.

<u>Option B: Distribution of the RDS funds solely to RDS-eligible members.</u>

The following describes a method by which CalPERS could distribute the entire amount of the RDS to members.

Method B-1: Use RDS funds to reduce prescription drug co-payments for Medicare Supplemental Plans for 2007.
Adjust benefit design to reduce prescription drug co-payments for 2007 based on the amount of the RDS that CalPERS projects it will receive for the 2006 benefit year. Reducing or eliminating co-payments would result in higher premiums for Medicare Supplemental plans; higher premiums would then be “bought-down” through use of the RDS. (Note that under PEMHCA, this method could not be applied for only State Medicare members without also being applied to contracting agency Medicare members.)

PROS:

- Avoids potential HIPAA violations.
- Direct benefit to members.

- Minimizes administrative costs.

CONS:
- Contradicts previous Board policy and action on prescription drug co-payments.
- Lower member prescription drug co-payments and deductibles may reduce current incentives for members to use mail-order in preference to retail pharmacies, and generic and formulary drugs in preference to non-formulary drugs. Resulting changes in behavior could result in increased premiums in future years.
- Employers receive virtually no RDS funds and are likely to dispute this method of implementation.

Option C: Distribution of the RDS funds to both employers and RDS-eligible members.

The following describes three methods by which CalPERS could distribute RDS funds to both employers and members.

Method C-1: Use RDS funds to reduce 2007 premiums for Medicare Supplemental Plans.
After the base premiums for 2007 are negotiated, CalPERS would distribute the RDS funds to the health plans based on claims experience for each plan's RDS-eligible population. CalPERS would then reduce the overall premiums for the Medicare Supplemental plans by the amount of the RDS funds that each health plan received.

PROS:
- Avoids potential HIPAA violations.
- Does not result in employers receiving RDS amounts that reflect more than their retiree health premium contribution rates.
- Has the least impact on existing operations and the easiest additional infrastructure to incorporate.
- Minimizes administrative cost.

CONS:
- No direct benefit to those RDS-eligible members who currently have no premium contributions.
- Lower savings for some contracting agencies than other employer disbursement methods. (Employers that contribute a flat amount for health premium costs would not realize savings if the lowered premiums are still higher than the amount of the employers' premium contribution.)

Method C-2: Distribute RDS funds to employers and RDS-eligible members in 2007 based on the proportion each contributed toward health coverage premiums in 2006.
CalPERS would calculate the average prescription drug cost by dividing the total amount of drug expenditures by the total number of RDS-eligible members in the

CalPERS program. CalPERS would divide the average prescription drug cost between each RDS-eligible member and their employer, based on the percentage that each contributed to the total health coverage premium cost and arrange for individual checks to be sent to members in the mail. Employers would receive fund transfers electronically using existing systems.

PROS:

- Avoids potential HIPAA violations.
- Does not result in employers receiving RDS amounts that reflect more than their retiree health coverage premium contribution rates.
- Direct benefit to members.

CONS:

- Implementation would be complex and the most costly of all methods.
- Checks sent to RDS-eligible members may be subject to withholding requirements as taxable income.

Method C-3: Distribute prescription drug co-payment discount vouchers to State RDS-eligible members and use the contracting agency share of RDS funds to reduce 2007 premiums for contracting agencies Medicare Supplemental plans. CalPERS would calculate the average prescription drug cost by dividing the total amount of drug expenditures by the total number of RDS-eligible members in the CalPERS program. CalPERS would divide the average prescription drug cost between each State RDS-eligible member and the State of California, based on the percentage that each contributed to the total health coverage premium cost (same as Method C-2 up to this point). The funds representing the State RDS-eligible members' portion (approximately $1.2 million or about $15 per member) would be distributed to State RDS-eligible members in the form of prescription drug co-payment discount vouchers. The State of California would receive fund transfers electronically using existing systems. The contracting agency portion would be distributed by reducing 2007 premiums for contracting agencies' Medicare Supplemental plans.

PROS:

- Avoids potential HIPAA violations.
- Does not result in employers receiving RDS amounts that reflect more than their premium contributions.
- Directly benefits all RDS-eligible members while recognizing State and contracting agency employer contributions.

CONS:

- Not as cost-effective and administratively feasible as Method C-4.

Method C-4: Distribute RDS funds in 2007 to the State of California based on claims experience of State RDS-eligible members in 2006 (Method A-1) and use the balance of RDS funds to reduce 2007 premiums for contracting agencies' Medicare Supplemental plans (Method C-1).

PROS:

- Best-balanced option that meets the evaluation criteria.
- Avoids potential HIPAA violations.
- Does not result in employers receiving RDS amounts that reflect more than their premium contributions.
- Directly benefits contracting agency members while recognizing contracting agency employer contributions.

CONS:

- No direct benefit to State RDS-eligible members.

V. STRATEGIC PLAN:

This proposal supports Strategic Plan Goal III, which requires CalPERS to design, develop and administer benefit programs and business processes that are innovative, effective, efficient and valued by our members, employers and stakeholders.

VI. RESULTS/COSTS:

Staff is developing processes related to the administration and distribution of RDS funds. Attachment 1 reflects estimated RDS distribution for each option.

Staff will assess whether legislation is needed to support implementation. If legislation is necessary, the Office of Governmental Affairs (GOVA) will present the proposed legislation to the Board as part of the CalPERS proposed legislative program for 2006.

Staff will mail a detailed pro-forma of administrative costs and a report on co-payment reduction alternatives and their cost impacts prior to the November 2005 HBC meeting.

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Attachment